

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM STATEMENT OF INVESTMENT POLICY

FOR ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM

~~February 16, 2010~~ October 17, 2011

This policy is effective immediately upon adoption and supersedes all previous Alternative Investment Management (AIM) Program policies.

I. PURPOSE

The CalPERS Total Fund Statement of Investment Policy, adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Alternative Investment Management (AIM) Program ("Program"). The design of this Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this policy assures sufficient flexibility in managing investment risks and returns associated with this Program.

II. STRATEGIC OBJECTIVE

To maximize risk-adjusted rates of [return](#) while enhancing the CalPERS position as a premier alternative investment manager is the strategic objective of the Program.

The Program shall be managed to enhance the equity return to the Fund.

~~accomplish the following:~~

- ~~A. Enhance CalPERS long-term total risk-adjusted return;~~
- ~~B. Enhance CalPERS reputation as a premier alternative investment manager and "investor of choice" within the private equity community;~~
- ~~C. Hedge against long-term liabilities; and~~
- ~~D. Provide diversification to the CalPERS overall investment program.~~

III. RESPONSIBILITIES

- A. CalPERS Investment Staff ("Staff") is responsible for the following:

1. All aspects of portfolio management including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark.
2. Reporting to the Committee annually and more often if needed about the performance of the Program. Staff will also report monthly to the Committee regarding investment proposals it has received, the stage they are at in the pipeline, and their ultimate disposition.
3. Monitoring the implementation of, and compliance with, the Policy. Staff shall report concerns, problems, material changes, and violations of guidelines and Policies to the Committee at its next meeting, or sooner if deemed necessary. These reports shall include explanations of all violations and appropriate recommendations for corrective action.
4. Evaluating and selecting [Alternative Investments](#).
5. In managing this Program, Staff will work cooperatively with the [External Resources](#) it has retained as part of the spring-fed pool. Their primary purpose shall be to serve as an extension of Staff. Staff may also use outside experts, as appropriate, to provide specialized expertise in various disciplines, on a one time basis.
6. Each investment over \$50 million must will be supported by a Prudent Person Opinion rendered by one of the External Resources in the Spring Fed Pool. For investments under \$50 million, receiving an Prudent Person Opinion is at the discretion of the SIO.

B. The ~~General Pension~~ Private Asset Class Board Investment Consultant

("Consultant") is responsible for:

The responsibilities of the Consultant are specified in Statement of Investment Policy for Role of the Private Asset Class Board Investment Consultants. Monitoring, evaluating, and reporting quarterly, to the Committee, on the performance of the Program relative to the benchmark and Policy.

C. The [General Partner](#) ("General Partner") is responsible for:

All aspects of portfolio management as set forth in each General Partner's [limited partnership](#) agreement or contract with CalPERS.

IV. PERFORMANCE OBJECTIVES AND BENCHMARKS

A. Performance Objective

The performance objective of the Program is to enhance the equity return of the fund.

The benchmark for the Program is specified in the Benchmarks Policy.
~~The expected performance objective of the Program shall be the 10-year rolling average for the total return of the CalPERS Custom Wilshire 2500 Index plus a 300 basis point risk premium lagged by one quarter. The performance objective is net of fees and expenses.~~

~~Use of the CalPERS Custom Wilshire 2500 Index reflects the opportunity cost of investing in Alternative Investments versus publicly traded common stocks. The 10-year rolling average smoothes short-term volatility, is intended to cover at least one complete market cycle, and is consistent with the anticipated average term of the partnership investments. Further, the one quarter lag takes into consideration the delay in receiving valuations from the investment managers.~~

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approach

1. Staff shall manage the Program as a whole with specific criteria appropriate to partnership investments [Direct Investments](#) (including “[Independently Sourced Investments](#)” and “[Co Investments](#)”) and [New Vehicles](#).
 - a. Investment opportunities will be classified as partnership investments when decision-making and management discretion is granted to outside managers.
 - b. Investment opportunities shall be classified as direct investments if CalPERS retains discretion and manages the investment internally or through its external resource(s).
 - c. New Vehicles shall include innovative structures that provide a means to access investment opportunities, exploit CalPERS strengths, and achieve the maximum risk-adjusted rates of return. New Vehicles may include partnerships and direct investments or both.

2. “Top down” strategic assessments shall identify portfolio weightings and identify the most attractive segments of the market for investing. Based on these assessments, the Staff shall proactively seek out the most attractive investment opportunities, while maintaining appropriate diversification.
3. Depending on the form and character of the investment, the Program sets minimum standards for each investment.

B. Specific Risk Parameters

There are specific [risks](#) associated with investments that shall be monitored and mitigated by CalPERS. Each segment of the alternative investment market contains uncertainties that are unique to it. CalPERS shall manage the following major categories of uncertainties commensurate with the expected return as an investment proposal is considered:

1. [Leverage](#): Some investments may use [non-recourse debt](#) (leverage) which may increase the volatility of returns.
2. Operating and Business: Certain investments may entail above average operating and business risk.
3. Liquidity: Alternative investments lack liquidity and typically have time horizons of 5-to-10 years. Secondary markets for such investments are very limited. The ability to negotiate specific “exit” rights (e.g., registration rights, puts and calls) are generally applicable only to Direct Investments.
4. Structural: CalPERS negotiates and structures specific fundamental rights and protections, which include mechanisms for taking remedial action. These basic protections include where appropriate [advisory committee](#) participation and specific termination provisions in partnership [transactions](#); and anti-dilutions, put and call options, voting rights for material events, and other covenants and governance provisions in the case of direct investments.
5. Valuation: Partnerships and co-investments shall be evaluated to determine if the general partner employs an appropriate valuation discipline. For direct investments, the Staff shall review valuations to determine if they are reasonable.

The portfolio shall reduce risk through appropriate diversification by geography, industry, [vintage year](#) and investment strategy.

C. Investment Selection

1. The Program shall consider any appropriate investment opportunity with the potential for returns superior to traditional investment opportunities. Investments can be in any industry or geography and may include, but are not limited to:
 - a. [Buyouts](#) or [Corporate Restructuring](#)
 - b. [Expansion Capital](#)
 - c. [Venture Capital](#)
 - d. ~~Distressed Securities~~[Credit Related](#)
 - e. ~~Turnarounds~~[Opportunistic](#)
 - f. ~~Special Situations~~
2. Staff shall develop and maintain selection guidelines for Alternative Investments to include the following:
 - a. Minimum requirements with respect to the following:
 - (1) General Partner's relevant investment experience and specific qualifications
 - (2) General Partner's ability to work together
 - (3) General Partner's ability to dedicate sufficient time and attention to the undertaking
 - (4) Basic investment vehicle terms
 - (5) Investment goals and objectives
 - b. Performance criteria
 - c. [Due Diligence](#) process
 - d. Legal constraints or requirements
 - e. Reporting requirements

- f. Quality control processes including, but not limited to, investment monitoring and risk control
- g. Other relevant parameters that may apply

D. Investment Parameters

Alternative Investments may operate under a limited partnership agreement, limited liability company (LLC), or other similar legal structure.

All legal structures shall include specific, written investment guidelines. The guidelines shall outline the fund's investment philosophy and approaches, representative portfolio characteristics, permissible and restricted procedures, and a performance objective commensurate with the investment risk to be incurred.

Implementation of this Program shall comply at all times with the applicable CalPERS investment policies.

E. Sub-Asset Class Allocations

The categories and ranges for sub-asset classes shall be as follows:

<u>Strategy</u>	<u>Target</u>	<u>Range</u>
<u>Buyouts</u>	<u>60%</u>	<u>50% - 70%</u>
<u>Credit Related</u>	<u>15%</u>	<u>10% - 25%</u>
<u>Venture Capital</u>	<u>1%</u>	<u>0% - 7%</u>
<u>Growth/Expansion</u>	<u>15%</u>	<u>5% - 20%</u>
<u>Opportunistic</u>	<u>10%</u>	<u>0% - 15%</u>

E.F. Leverage

Recourse Debt shall not be permitted.

Non-recourse Debt may be utilized by an underlying investment within a partnership or a direct investment. Staff monitors the non-recourse debt as a risk factor.

VI. CALCULATIONS AND COMPUTATIONS

Investors, managers, consultants, and other participants selected by CalPERS shall make all calculations and computations on a market value which shall be recorded by CalPERS Custodian.

VII. GLOSSARY OF TERMS

Key words used in the policy are defined in CalPERS Master Glossary of Terms.

Approved by the Policy Subcommittee:	April 4, 1997
Adopted by the Investment Committee:	April 14, 1997
Revised by the Policy Subcommittee:	March 11, 2005
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Approved by the Investment Committee:	September 15, 2008
Administrative changes made due to Policy Review Project:	June 16, 2009
Revised by the Policy Subcommittee:	December 14, 2009
Approved by the Investment Committee:	February 16, 2010
Revised by the Policy Subcommittee:	October 17, 2011

Advisory Committee

A group of investors in the partnership whose primary functions are to address certain partnership-related issues. Based on the roles and responsibilities outlined in limited partnership agreement, the Advisory Board may review conflicts of interest, approve valuation policies, review operating budgets, vote on partnership term extensions, and perform other duties as deemed appropriate.

Alternative Investments

Investments that are privately-held and illiquid. These investments are often structured as limited partnerships with strategies of investing in venture capital, growth equity, buyouts, mezzanine financing, and other investment strategies that are not based on public market activities.

Buyout

The purchase of all or part of the stock or assets of a company through the use of debt and equity. The company may be privately or publicly owned.

~~CalPERS Custom Wilshire 2500 Index~~

~~The Wilshire 2500 Index, excluding Real Estate Investment Trusts (REITs) and tobacco stocks, and with dividends reinvested. The Wilshire 2500 comprises the top 2500 securities of the Dow Jones Wilshire 5000 Index, excluding REITs and tobacco stocks, based on market capitalization, and is reconstituted annually. The Dow Jones Wilshire 5000 is an index that measures the performance of all U.S. headquartered equity securities with readily available price data.~~

Co Investment

A direct investment into a portfolio company by limited partners alongside the general partner and generally done so on similar terms.

Corporate Restructuring (Buyouts)

Investments in the form of equity and/or debt of a public or private company designed to restructure the current capital structure of the company, including debt and equity buybacks, exchange offers and refinancings. Related terms include leveraged buyouts, management buyouts, employee buyouts, and buy-and-build strategies.

Credit Related

Investments in Distressed Securities, Mezzanine, Debt, Turnaround strategies or other similar debt related strategies

Direct Investment

An investment in which CalPERS has ownership interest in a company.

Distressed Securities

Debt or equity securities of companies that are in financial distress. These securities tend to trade at significant discounts and attract investors that perceive a turnaround.

Due Diligence

The process of checking and verifying information as well as ensuring that sufficient analysis has been conducted before making an investment recommendation.

Expansion Capital (Growth Equity)

Investment in an established company for the purpose of growing its business.

External Resource(s)

Includes management consultants, accountants, industry specialists, traditional pension fund consultants, investment bankers, or industry experts.

General Partner

The manager of a limited partnership. The general partner has full responsibility and complete discretion for investing the capital. The general partner also bears personal liability for any lawsuits that arise from the investment's activities, but is often broadly indemnified by the limited partners.

Independently Sourced Investment

A type of direct investment which is sourced through contacts other than the general partners with which CalPERS is invested.

Leverage

The use of debt, derivative instruments, reinvestment of cash collateral, or other means to acquire more assets than the capital employed.

Limited Partnership

The most common format used in structuring private equity investments. Limited partners provide the capital but have no direct involvement in the management of the fund. Limited partners have limited liability but also have limited control over the management of the fund.

Management Fee

The fee paid to the General Partner to manage the fund.

New Vehicle

An investment in a fund where CalPERS partners with a firm that has a distinctive competitive advantage in an industry, geographic region or investment

style. New Vehicles shall be limited to investments in fund of funds or separate account investments.

New/Emerging Management Team

A new general partnership that raises a first or second time institutional fund. This may include funds being raised by an established General Partner that is targeting a new strategy or has hired a new management team.

Non-recourse Debt

Financial obligation for which an investor has no current or contingent liability. Non-recourse debt includes the liabilities of a publicly traded company of which an investor owns shares and financial obligations of a partnership or a non-publicly traded company of which an investor is a limited liability investor. Non-recourse debt includes debt that is recourse only to a certain investment, such as a separate account or a commingled fund, and is non-recourse to CalPERS. For an investment with non-recourse debt, the maximum potential loss is limited to the amount of the investment.

Opportunistic

Nontraditional investment strategies that are driven by current market circumstances and typical in private equity. Such non-traditional investment strategies include, but are not limited to, active minority positions, governance strategies, sector-specific strategies, and other strategies that may use unconventional instruments such as debt arrangements, collateralizations, corporate joint ventures, credit enhancements, leasing, off-balance sheet financings, etc.

Partnership Investment

An investment in a Limited Partnership.

Private Asset Class Board Investment Consultant

An individual or organization that provides specialized professional assistance to the Investment Committee related to an asset class regarding strategy and policy analysis, performance analysis and monitoring, and independent advisory service to the Investment Committee.

Prudent Person Opinion

An opinion from an External Resource that the proposed investments is a prudent investment consistent with Article XVI Section 17(c) of the California Constitution and Section 20151(c) of the California Government Code. An opinion from a consultant or external resource subject to the Fiduciary Standard of Care that the proposed investment is a prudent investment consistent with Article XVI, Section 17(c) of the California Constitution and Section 20151 (c) of the California Government Code, i.e., made with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in

a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

Recourse Debt

Amount of a debt guarantee; a financial liability contingent on the occurrence of an event such as borrower default or a certain decline in the equity value of an investment. Recourse debt includes letters of credit, lines of credit, Credit Accommodations, Subscription Financing, and other financing vehicles that serve as debt guarantees.

Return

A measure of the total performance of an investment over a designated time period. The return calculation for private equity is typically based on the internal rate of return, net of all fees and expenses.

Risk

A measurable probability of losing or not gaining value. Risk is differentiated from uncertainty, which is not measurable. Risk in this context is also referred to as "standard deviation", which is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

Special Situations

A term used to describe non-traditional investment strategies that are typical in private equity. Such non-traditional investment strategies include, but are not limited to, , active minority positions, governance strategies, sector-specific strategies, and other strategies that may use unconventional instruments such as debt arrangements, collateralizations, corporate joint ventures, credit enhancements, leasing, off-balance sheet financings, etc.

Term

The duration of the partnership or direct investment.

Transaction

An agreement between a buyer and a seller to exchange an asset for payment. A transaction often takes the form of a partnership, co-investment, or direct investment.

Turnarounds

Investments in companies experiencing financial and/or operating issues. These companies may or may not be insolvent.

Venture Capital

The financing of rapidly-growing companies that do not have access to public equity or debt financing. Early-stage venture capital may involve financing a company during its initial years when assets may be limited and when there may

be no revenues. Late-stage venture, sometimes referred to as growth equity or expansion capital, may involve financing a company that has established products or services and revenues.

Vintage Year

The year in which the first capital drawdown of the partnership occurs.